Comments of the Western Power Trading Forum to the California Air Resources Board on 2016 Amendments to the Cap and Trade Regulation

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Clare Breidenich

WPTF GHG Committee Director

cbreidenich@aciem.us

The Western Power Trading Forum[1] (WPTF) welcomes the opportunity to provide input to the California Air Resources Board (CARB) on its consideration of possible amendments to the Cap and Trade program for the third compliance period and the post-2020 program, including California Compliance with the Clean Power Plan (CPP).

First, as it is early in the rule-making process, WPTF is not yet in a position to provide detailed comments on the specific items, such as stream-lining of information management and cost containment provisions, identified by CARB as areas for revision. However, WPTF reiterates the need for the scope of the cap and trade amendments for the third compliance period to include full evaluation and clarifications to the procedures and requirements for the RPS adjustment. As WPTF explained at the October 2nd workshop, we are very concerned that the way that CARB is interpreting and implementing the RPS adjustment requirements is unworkable and is creating conflicts with contractual terms.

Additionally, we believe that dedicated consideration of electricity sector issues is warranted within the cap and trade amendment rule-making. In addition to the need to consider any necessary changes to the California cap and trade program to comply with the CPP, CARB must also consider changes that may be needed in response to other state CPP plans, particularly the treatment of electricity imports. At the same time, regional energy markets are changing quickly – the California ISO Energy Imbalance Market is expanding to include 5 non-California balancing area authorities and transformation of the CAISO into a regional grid organization could occur within the next few years. These changes necessitate careful consideration of whether and how carbon associated with electricity imports will be regulated in the future, and, if so, what role the ISO will play in facilitating this.

For these reasons, WPTF requests that CARB hold a workshop to identify and discuss possible amendments relating to the electricity sector for both the third compliance period and the post-2020 program. Given the importance of these issues and the fact that the CAISO plans to revisit GHG accounting issues in early 2016, we recommend that CARB schedule the workshop as soon as possible.

The remainder of these comments addresses CARB's proposed strategy for compliance with the CPP.

CARB Should Aim to Develop a "Trading-Ready" CPP Compliance Plan

WPTF agrees with much of the framework for the California CPP compliance strategy outlined in the CARB discussion paper and staff presentation. Specifically, WPTF agrees that California should pursue a mass-based plan based on the California Cap and Trade Regulation and that the multi-sector nature of California's cap and trade program, its linkage to Quebec, and the use of carbon offsets necessitates a "State Measures" approach. We also agree that the level of emissions from California electricity generation over the CPP compliance period are likely to be well below the

[1] WPTF is a diverse organization comprising power marketers, generators, investment banks, public utilities and energy service providers, whose common interest is the development of competitive electricity markets in the West. WPTF has over 80 members participating in power markets within California and elsewhere across the United States.

level of EPA's CPP target for California, and that as a result, the triggering of backstop measures is extremely unlikely.

However, WPTF is concerned that neither the discussion paper nor the presentation reflect consideration of linking California's cap and trade program with any electricity-sector-only cap and trade programs adopted in other states to comply with the CPP. Although mention is made of regional collaboration and opportunities for linking, the option for California to adopt an EPA-approved "trading-ready" plan is not explored.

Linked allowance trading programs throughout the west and nationally would have significant advantages in terms of delivering long-term emission reductions and ensuring a common and consistent carbon price signal for generator dispatch and investment. WPTF therefore urges CARB to develop a 'trading-ready' CPP compliance plan that would enable linkage to any other EPA-approved, mass-based, CPP allowance-trading program.

The CPP Provides a Mechanism to link California's Program to other CPP Allowance Trading Programs

The mechanism to link California's multi-sector cap and trade program to electricity-sector only cap and trade programs has been intentionally and explicitly addressed by the US Environmental Protection Agency in the CPP. It would work as follows:

- CARB would impose annual emissions caps under the California Cap and Trade Regulation consistent with the State's 40% GHG emission reduction goal and issue allowances up to the level of these caps. For CPP compliance, CARB would establish EGU mass standards (i.e. final and interim) for electricity generating units (EGUs) at the levels set for the state by EPA. CARB would also request approval for the plan to be deemed trading-ready.

- Once approved by EPA, California-issued allowances could be used for compliance by EGUs in any other mass-based, trading-ready state. CARB would modify the cap and trade regulation to enable covered entities to use allowances issued by other trading-ready states.

- Because its CPP plan would be a state measures approach, California would demonstrate ongoing CPP compliance by comparing total EGU emissions to its EGU mass standards. (As a result of the multi-sector nature of California's cap and trade program, enforcement of the program requirements on EGUs will not mathematically ensure attainment of California's CPP EGU standards.)

- In making this comparison, California would adjust the total reported EGU emissions by the quantity of allowances imported from other CPP states, or exported to other CPP states or Canadian provinces.[2] In this way, net imports of allowances from other CPP states would have the effect of raising California's EGU mass standards. Imports from Canadian provinces would not have this effect. All exports of California allowances have the effect of decreasing California's EGU mass standards.

[2] http://www2.epa.gov/cleanpowerplan/clean-power-plan-existing-power-plants#CPP-final at §60.5740(a)(2)(ii)(H) and correction to §60.5740(a)(2)(ii)(H) in http://www.arb.ca.gov/cc/powerplants/errormemos/9.3.15.111d.pdf at page 13

- Other states that adopt allowance trading under the CPP are likely to do so only for the electricity sector so that their program cap is equivalent to the CPP EGU standards for the state. These states will not need to compare total EGU emissions to their EGU standard in order to demonstrate ongoing compliance (and thus do not need to adjust emissions for net imports/exports of allowances.) Rather these states must simply ensure that each EGU retires sufficient allowances to cover its emissions.[3] The allowances may come from any EPA-approved CPP allowance trading state.

A Trading-Ready CPP plan will not Reduce Environmental Integrity

In response to questions at the workshop, CARB staff cited three concerns about the impact that linkage to other state programs would have on the environmental integrity of California's GHG efforts or the CPP itself. WPTF believes that two of these concerns are misplaced, and that program design changes could address the third.

- **Allowance Surplus/Overhead:** CARB's first concern is based on the view that California's over-compliance relative to EPA's CPP emission target for the state would result in an allowance surplus. It then follows that linkage of California's program to other state CPP cap and trade programs would enable California's surplus to be used by EGUs in other states so that the level of emission reductions achieved by other states would be lower than it would it be if California's program were not linked.

  WPTF considers this concern to be unwarranted. CARB would issue allowances only up to the level of the cap under the state cap and trade regulation. Because the level of these caps would reflect expected electricity sector emission levels consistent with the state's AB32 targets and other state GHG mandates, then should not be any allowance surplus.

- **Emissions Leakage:** CARB's second concern relates to emissions leakage. Emissions leakage in a general sense refers to the situation where emission reductions in one place are offset by emission increases elsewhere, so that the overall level of emission reductions are lower than intended. If California links its cap and trade program to other states' programs, the combined caps will ensure that the overall level of emissions reductions occurs, but trading alters where the reductions occur geographically. Changes in the relative emissions levels across states would happen, but this would not be emissions leakage – it would be emissions trading.

  Linkage of the California program to other state CPP allowance trading programs would actually decrease the potential for emissions leakage in the electricity sector. If all Western states adopted CPP linked cap and trade programs, then electricity generators throughout the West would be subject to a common carbon price. This would eliminate the incentives and opportunities for emissions leakage between California and out-of-state generators. Further, the CPP itself will reduce risks of emission leakage, as all states are required to reduce GHG emissions from electricity generation.

[3] http://www2.epa.gov/cleanpowerplan/clean-power-plan-existing-power-plants#CPP-final at §60.5825

- **Compliance with State GHG targets:** The third, and thornier CARB concern has to do with the possible impact of linkage on California's efforts to achieve the Governor's 40% GHG emission reduction goal. Linkage of California's cap and trade program to other state programs would impact allowances prices and the direction of allowance transfer. The relative prices of California allowances to that of other states in the absence of trading (which is a factor of the marginal cost of emission reductions in each state) will determine whether California capped entities are net buyers or sellers of allowances to/from other states. If California allowance prices are inherently higher than those of other CPP states, then California entities will buy allowances and in-state emissions would increase, making it less likely that the state will achieve the 40% GHG goal.

  Modifications to the design of the cap and trade program or other GHG programs could mitigate this risk. In order to evaluate whether such program design changes are warranted, it would first be necessary to assess the sensitivity of emission levels in capped sectors to changes in allowances prices that may occur if California's cap and trade program is linked to other CPP programs. WPTF has provided separate comments to CARB for the Scoping Plan Development that recommends that these questions be assessed in the context of the Scoping Plan Economic Analysis.

Finally, WPTF recognizes that SB1018 in its current form poses a real barrier to linking California's program to other CPP programs. WPTF suggests that the legislature's ongoing consideration of codification of the 40% GHG reduction goal in state law provides an opportunity for revisiting SB1018.